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Office Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

POLAROID CORPORATION,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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POLAROID CORPORATION,
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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

To the Honorable Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the First Circuit, entered May 3, 1960, affirming in part a decision of the Tax Court of the United States entered November 24, 1959.

Report of Opinions

The opinion of the United States Court of Appeals for the First Circuit, not yet officially reported, is annexed as Appendix "A" to this petition. The opinion of the Tax Court of the United States is reported at 33 TC No. 33 (1959) and is set forth in the record appendix (R. 6-18).

Grounds of Jurisdiction

The judgment of the United States Court of Appeals for the First Circuit was dated, and entered on, May 3, 1960 (Appendix "B" to this petition). Jurisdiction of this Court is invoked under Section 1254(1) of Title 28 of the United States Code.

Questions Presented

1. For the purpose of determining petitioner's abnormal income under Section 456 of the Internal Revenue Code of 1939, does the income resulting from its revolutionary basic scientific discoveries extending over a period of more than 12 months constitute income from "discovery" within the class of income described in Section 456(a)(2)(B)?

2. If such income is not entitled to be classified as "discovery" income under Section 456(a)(2)(B), does it nonetheless constitute abnormal income under Section 456?

Constitutional Provisions, Statute and Regulations Involved

This case involves the following constitutional provisions, statute and regulations:

Article I, Sections 1 and 8 of the Constitution of the United States;

Section 456 of the Internal Revenue Code of 1939; and

Sections 40.456-1(a) and 40.456-2(a) and (b) of the Treasury Regulations 130 (1951) as amended, promulgated under the Internal Revenue Code.

The said constitutional provisions, statute and regulations are set forth in Appendix "C".*

Statement of the Case

Petitioner instituted this proceeding in the Tax Court of the United States for redetermination of deficiencies determined by respondent in petitioner's income and excess profits tax amounting to $87,935.72, $220,260.07 and $261,682.44 for the years 1951, 1952 and 1953, respectively, and for a review of respondent's disallowance of petitioner's claim for refund of income and excess profits tax of $193,908.85 for the year 1951. The jurisdiction of the Tax Court was invoked under Sections 272 and 1101 of the Internal Revenue Code.

The Tax Court held that petitioner's income from certain basic scientific discoveries hereinafter described did not constitute abnormal income within the meaning of Section 456 of the Internal Revenue Code, and sustained the deficiencies as determined by respondent (R.-5).

On appeal, the Court of Appeals for the First Circuit affirmed the decision of the Tax Court on this issue.** (Appendix "A", pp. 1a-14a). This petition seeks a review of the judgment of the Court below on such issue.

Petitioner's basic scientific discoveries were (i) the Polaroid Land Process, consisting of the Polaroid Land Camera and the Polaroid Land Picture Roll—a revolutionary photographic system in which by one-step dry

* All references to statutory provisions are to the Internal Revenue Code of 1939, as amended, unless otherwise expressly specified.

** The Tax Court also held that interest credited to petitioner on a refund of excess profits tax for the years 1942 and 1943 was to be reduced by interest charged on deficiencies in income tax for those years, in determining petitioner's net abnormal income from "interest". The determination of the Tax Court on this issue was reversed by the Court of Appeals and such issue is not involved on this petition.

processing the developing and printing of the picture take place simultaneously within the camera, enabling the user to obtain a finished dry positive print directly from the camera within 60 seconds, and (ii) the Polaroid 3-dimensional synthetic light polarizer—a device used in the exhibition of 3-dimensional motion pictures.

All of the facts were stipulated, and the only question was the construction of Section 456(a)(2).*

Petitioner contended that its income from the Polaroid Land Process and the Polaroid 3-dimensional synthetic light polarizer fell within the class of income described in subparagraph (B) of Section 456(a)(2)**, as income resulting from "discovery"; that even if said income were not properly classifiable under said subparagraph (B), the Secretary was obligated to classify it by virtue of the last sentence of paragraph (2)***: that the Treasury Regulations implementing said last sentence of paragraph (2)†, should be so construed as to allow such income to con-

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* Under paragraph (1) of Section 456(a) income is abnormal if it falls within a class under paragraph (2) and in amount exceeds 115% of the average gross income of the same class during the four previous tax years. That petitioner's income from each of its scientific discoveries during the respective tax years met the mathematical requirement of paragraph (1) was conceded (Appendix "A", p. 3a).

** "(B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months".

*** "The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary".

† "Other income, not within a class described in subparagraphs (A)-(D) of section 456(a)(2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456(a)(2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice. * * *" (Regulations 130, section 40.456-2b (Appendix "C", pp. 22a-23a).)

stitute a class of income under Section 456(a)(2); and that if not so construed, the Regulations are invalid as reducing the area of relief provided in the statute.

The Court of Appeals conceded that the Polaroid Land Process and the Polaroid 3-dimensional synthetic light polarizer were revolutionary discoveries (Appendix "A", p. 2a), but held that the word "discovery" in subparagraph (B) of Section 456(a)(2) relates solely to the mining industries and does not encompass scientific discoveries, whatever their nature or magnitude (Appendix "A", p. 8a). The Court of Appeals further held that the last sentence of Section 456(a)(2), while authorizing the Secretary to accept classifications outside the express provisions of subparagraphs (A) to (D), did not obligate the Secretary to do so, and that the Treasury Regulations did not establish any class of income in which to place petitioner's income from its scientific discoveries (Appendix "A", pp. 11a-12a).

Reasons for Granting the Writ

I. The decision below is in direct conflict with the decision of the Court of Appeals for the Seventh Circuit in *G. D. Searle & Co.* v. *Jarecki*, 274 F. (2d) 129 (1960).

II. This case presents an important question of Federal excess profits tax law which has not been, but should be, decided by this Court.

The Government has filed with this Court its petition for a writ of certiorari to review the judgment of the Court of Appeals for the Seventh Circuit in the *Searle* case, supra. In such petition the Government has stated:

> "• • • The Court of Appeals for the First Circuit in Polaroid Corp. v. Commissioner (decided May 3, 1960) • • • has expressly disagreed with the Seventh Circuit's decision here. We have been

advised that the taxpaper in *Polaroid* will seek review by this Court, and the Government intends not to oppose the petition in that case" (Government's petition for a writ of certiorari, No. 1011, filed June 16, 1960, p. 4).

I

The decision below directly conflicts with the decision of the Court of Appeals for the Seventh Circuit in *G. D. Searle & Co.* v. *Jarecki*, 274 F (2d) 129 (1960).

In *G. D. Searle & Co.* v. *Jarecki*, 274 F (2d) 129 (1960),* the taxpayer asserted that its income from the drugs Banthine and Dramamine qualified as income from "discovery" within Section 456(a)(2)(B). The District Court granted summary judgment in favor of the Government, dismissing the complaint.**

The Court of Appeals for the Seventh Circuit held that the word "discovery", as used in the statute, did embrace scientific discoveries, and reversed and remanded the case to the District Court for determination of whether Banthine and Dramamine were in fact discoveries. This decision squarely conflicts with the determination of the Court below "that 'discovery', as used in subparagraph (B) of Section 456(a)(2), relates to the mining industries, and to nothing else." (Appendix "A", p. 8a).

This direct conflict was acknowledged in the opinion of the Court below. Characterizing the *Searle* case as "seemingly on all fours with this one, except that it came

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* For the convenience of this Court, the opinion of the Court of Appeals for the Seventh Circuit is set forth in Appendix "D", pp. 24a-29a.

** The decision of the District Court is not officially reported. It is unofficially reported at 59-1 USTC §9465 (No. Dist. Ill., East. Div. 1959).

up on the granting of the government's motion for summary judgment of dismissal", the Court below stated that "the opposite conclusion was reached" in that case (Appendix "A", pp. 6a, 8a).

The aggregate amount of taxes involved in the "discovery" issue in the present case is approximately $670,000. As stated in the complaint in the *Searle* case, *supra*, the aggregate amount of taxes involved on such issue in that case exceeds $3,600,000.* Accordingly, a definitive resolution of such issue by this Court is of importance to both the Government and petitioner.

II

This case presents an important question of Federal excess profits tax law which has not been, but should be, decided by this Court.

Apart from the substantial amount of taxes involved, the question of statutory construction presented in this case and the *Searle* case is of major significance in the field of Federal excess profits taxation. A decision by this Court is essential on the question of whether Congress intended that certain of the relief provisions for abnormal income under the Excess Profits Tax Act of 1950 should pertain only to special industries, or whether Congress intended generally to provide relief for all corporations having such abnormal income.

The meaning ascribed by the Court below to the word "discovery" in Section 456(a)(2)(B), as confined only

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* In the Government's petition to this Court for a writ of certiorari in the *Searle* case it is stated:

> "In addition, as the result of a preliminary search, the Internal Revenue Service informs us that there are pending administratively (or in the Tax Court) at least five other cases, involving approximately six million dollars in taxes" (Government's petition for a writ of certiorari, No. 1011, filed June 16, 1960, p. 7).

to the extractive industries, penalizes and discriminates against enterprises which have encouraged their most talented and resourceful people to apply their knowledge, training and acumen to the discovery of breakthrough inventions. In this era when scientific discoveries are of vital importance to the nation's welfare, when the survival of our civil, political and economic way of life may depend upon building strength through invention, the efforts and achievements of our scientists are among our major natural resources. During the war period in which the statute was enacted, the encouragement of basic scientific discovery was as essential to the nation's interests as the encouragement of the discovery of sources of ores and oil. In that context it is difficult to conceive that Congress intended to deny to a basic scientific "discovery" the tax relief afforded to the "discovery" of oil and minerals.

Webster's New International Dictionary (Second Edition) defines "discovery" as follows:

> "discovery: Act, fact, process or instance of discovering, as: *a* Finding out or ascertaining something previously unknown or unrecognized * * *."

Consistent with this common meaning, Congress since 1790 has used the word "discovery" throughout our statutes pertaining to patentable inventions.*

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* Section 101 of 35 U. S. Code provides: "Whoever invents or discovers any new and useful process * * * may obtain a patent therefor". For further instances of the usage together of "invention and discovery" in the patent statutes, see the so-called Boykin Act, Public Law 690, 79th Cong. 2d Session, ch. 910; 60 Stat. 940, sections 2, 2(a), 2(b), 3; the so-called Veterans Patent Extensions Act, 64 Stat. 316, as amended by 66 Stat. 321; the Tennessee Valley Authority Act, 16 U. S. Code, Sec. 831d(i); the Mutual Security Assistance Act, 22 U. S. Code, Sec. 1668; the Atomic Energy Act, 42 U. S. Code, Sec. 2181, Sec. 2182; see also the Rules of Practice of the U. S. Patent Office, particularly Rules 65, 67 and 71.

In addition, our case law is replete with instances of the use of the word "discovery" by distinguished jurists to describe the contribution made by an invention.*

Cf. *Eibel Process Company* v. *Minnesota & Ontario Paper Company*, 261 U. S. 45, 63 (1923) (Chief Justice *Taft*; *Harries* v. *Air King Products Co. Inc.*, 183 F (2d) 158, 162 (2 Cir., 1950) and *Gillman* v. *Stern*, 114 F (2d) 28, 30, (2 Cir., 1940), cert. den. 311 U. S. 718 (1941) (Judge Learned Hand).

The determination of the Court below that a basic scientific contribution cannot constitute "discovery", as that term is used in Section 456(a)(2)(B) ignores the principle that words used in a statute are to be accorded their natural, ordinary and familiar meaning (Cf. *Avery* v. *Commissioner of Internal Revenue*, 292 U. S. 210, 214 (1934).

In view of the consistent use of "discovery" to describe significant originations in the field of science, if Congress in Section 456(a)(2)(B) had intended to limit the word solely to its geophysical meaning, it would have made its intention clear by express provision.

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* In patent law, courts have constantly distinguished between "genuine discoveries" which "advance the art substantially", and "slight improvements". *Eibel Process Company* v. *Minnesota & Ontario Paper Company*, 261 U. S. 45, 63 (1923). In the *Searle* case, *supra*, the admitted issuance of patents on the drugs in question was not in itself sufficient to establish discovery under Section 456(a)(2)(B), and the case was remanded to the District Court for determination of the issue of fact as to whether such drugs were "actually discoveries". The refusal of the Court below to recognize any difference between the "discovery" of a basic revolutionary invention, such as those concededly involved in this case, and that of an ordinary invention led it to the unwarranted conclusion that to interpret "discovery" in Section 456(a)(2)(B) as including scientific discovery would make the class of income described in Section 456(a)(2)(C) redundant (Appendix "A" p. 7a).

This was recognized by the Court of Appeals for the Seventh Circuit in the *Searle* case, *supra*:

> "If Congress had intended to limit the meaning of 'discovery' it would have been a simple matter for it to have expressly done so." (274 F. (2d) at p. 131).

Circumscription of the word's meaning also vitiates the rule that a statute is to be construed in the light of its purpose. Cf. *Central Bank* v. *United States*, 345 U. S. 639, 646 (1953); *United States* v. *Sullivan*, 332 U. S. 689, 693 (1948).

A main objective of the Excess Profits Tax Act of 1950 was to tax additional profits resulting from the wartime economy.

As was stated in House of Representatives Report No. 3142, 81st Congress, 2nd Session (1950). (51-1 CB at p. 187):

> "One of the main objectives in imposing an excess profits tax is to reach corporate profits which have been swollen by the increased tempo of the economy. An excess profits tax selects for additional tax those corporations whose profits are higher than they probably would have been in the absence of hostilities and a large military budget * * *."

The purpose of the relief provisions in such a law is to exempt abnormal income arising solely from a corporation's internal achievements and not from the stimulus of the war economy.

Cf. *Soabar Company*, 7 TC 89, 96 (1946).

Petitioner's profits during the tax years were not "higher than they probably would have been in the absence of hostilities and a large military budget". Its income

from the Polaroid Land Process and the Polaroid 3-dimensional synthetic light polarizer was derived from its own achievements and not from the stimulus of the war economy. Such income was the very kind of abnormal income for which Section 456 was designed to afford relief.

In holding that the word "discovery" relates to the mining industries and to nothing else, the Court below, in effect, declared that there is embedded in the statute, the structure of which manifests a purpose to provide general relief to all taxpayers having abnormal income, a section which affords tax relief only to special industries. The argument leading to such a narrow and discriminatory interpretation of the statute, was carefully considered and rejected by the Court of Appeals for the Seventh Circuit in the *Searle* case.*

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* In the *Searle* case, the Court said:

"We do not deem the maxim *noscitur a sociis* applicable. The wording of subparagraph (B) of the statute indicates that each word should be given significance independently of the others. It refers to 'exploration, discovery, or prospecting, or any combination of the foregoing'. The context in which the word appears suggests no reason to limit or qualify its commonly accepted meaning. That the statute herein involved omitted a provision of a similar World War II Excess Profits Tax Act which in defining abnormal income included that resulting from 'research, or development of tangible property' does not in our opinion serve to narrow the scope of the word 'discovery' as employed in the Internal Revenue Code provision here under consideration. The elimination of 'research' and 'development' as factors qualifying income for abnormal income classification served the Congressional objective of plugging 'a potential loophole of major dimensions'. And, absent the element of discovery, income resulting from research or development does not by reason of the latter factors qualify for treatment as abnormal income. But the plugging of the loophole which existed under a former Act because of the use of the unqualified terms 'research' and 'development' does not require that the word 'discovery' which the

Furthermore, the determination that the provisions of the last sentence of Section 456(a)(2) gave the Secretary the discretion but not the obligation to provide additional classifications of income, raises grave doubts as to the constitutionality of the statute (Appendix "A", p. 11a). So construed, this provision would constitute an improper delegation by Congress of its essential legislative functions, in violation of Article I, Sections 1 and 8 of the Constitution, for nowhere in the statute are there any standards, express or implied, for determining which additional classes of income the Secretary may elect to classify or refuse to classify.

Cf. *Panama Refining Co.* v. *Ryan*, 293 U. S. 388 (1935).

The words "any class" in this provision of the statute establish that the Secretary was under a mandate to classify all income and that only the designation of the class in which a particular type of income was to be placed was left to the Secretary's discretion. So construed, there would be no question as to its constitutionality.

Cf. *United States ex rel. Attorney General* v. *Delaware & Hudson Company*, 213 U. S. 366, 407 (1909).

Knights Templars' and Masons' Life Indemnity Company v. *Jarman*, 187 U. S. 197, 205 (1902).

The Court below adopted the characterization of petitioner as a "discovery company", exclusively engaged in exploiting its own discoveries (Appendix "A", p. 2a). Even if the word "discovery" in subparagraph (B) of

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Congress saw fit to re-employ in the later enactment be regarded as having taken on the limited and qualified meaning the Government would ascribe to it. Neither the context of Sec. 456 nor the legislative history demonstrates that the term 'discovery' was intended to describe only the discovery of that which is already in existence i.e. natural resources." (274 F (2d) at p. 131).

Section 456(a)(2) were limited to the discoveries of the mining industries, since petitioner's basic scientific discoveries were "discoveries" in a business of the type conducted by it, the income therefrom was properly grouped in a class similar to the class set forth in subparagraph (B), under the amplification of the classes of income provided in the regulations.*

The contrary construction placed upon the regulations by the Court below would make the regulations invalid as in contravention of the statute.

Morill v. *Jones*, 106 U. S. 466 (1883).

CONCLUSION

Petitioner prays that a writ of certiorari issue to the United States Court of Appeals for the First Circuit to review its judgment.

Respectfully submitted,

DAVID SAPERSTEIN,
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Of Counsel:
JULIUS SILVER,
ISAAC M. BARNETT.

* (Appendix "C", pp. 22a-23a).

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5622.

POLAROID CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES.

Before WOODBURY, *Chief Judge*, and HARTIGAN and ALDRICH, *Circuit Judges*.

Isaac M. Barnett, with whom *Julius Silver* and *Silver, Saperstein & Barnett* were on brief, for petitioner.

Norman H. Wolfe, Attorney, Department of Justice, with whom *Charles K. Rice*, Assistant Attorney General, and *Lee A. Jackson* and *Harry Marselli*, Attorneys, Department of Justice, were on brief, for respondent.

OPINION OF THE COURT.

May 3, 1960.

ALDRICH, *Circuit Judge*. This is a petition by Polaroid Corporation, hereinafter caller taxpayer, to review a de-

cision of the Tax Court holding that certain income received during the years 1951, 1952 and 1953 did not constitute "abnormal income" within the meaning of §456 (a)(2), Internal Revenue Code of 1939, 64 Stat. 1186 (1951), so as to qualify for the relief provided therein from the Korean War excess profits tax.[1] The taxpayer also contests a ruling that, in computing its net abnormal income for 1951 under §456(a)(3) of the Int. Rev. Code of 1939, the interest with which it was credited in 1951 upon its successful claim for an excess profits tax refund for the years 1942 and 1943 must be reduced by the interest it was charged on income tax deficiencies which resulted from the reduced excess profits tax. All facts were stipulated, and the only questions are of law.

Turning to the first issue, it appears that taxpayer was incorporated in 1937. In argument before this court it described itself as "a discovery company," exclusively engaged in exploiting its own discoveries. Edwin H. Land, its President and Director of Research, is internationally known for inventions in the optical and photographic fields, perhaps the most notable of which is the Polaroid Land Camera and film, income from the manufacture and sale of which constitutes the principal matter herein involved.[2] The camera and film together (they cannot be used separately) are termed by taxpayer the Polaroid Land process. This process is unique in that it enables any user to develop his own pictures and obtain positive prints anywhere, sixty seconds after exposure. Taxpayer describes this process as a "revolutionary discovery." We shall regard that characterization as accurate. Because

1. Excess Profits Tax Act of 1950, 64 Stat. 1137 (1951), which, with later additions, was classified as §§430-74, Int. Rev. Code of 1939, and is referred to hereinafter as the KW Act.

2. Also involved is income from sales of taxpayer's synthetic light polarizer for 3-D motion pictures. The parties agree the issues are the same, and that this matter need not be separately considered.

of numerous patents, taxpayer has no competitors. The result has been a very substantial return of income.

Taxpayer, under Land's direction, started to develop its process in 1944. Much expenditure of time and money was required before its satisfactory achievement in 1947. Unfortunately for taxpayer, large scale production and commercial success coincided with the Korean War years, as a consequence of which income attributable in part to activities in earlier years fell within the provisions of the KW Act. The Act contains several relief provisions. Taxpayer asserts that one in particular is applicable. The Commissioner has disagreed, and the Tax Court has sustained him.

Under the provisions of §456 of the KW Act, income is regarded as "abnormal income," and as such is relieved from the full incidence of the excess profits provisions by reallocation to other tax years, if it falls into certain specified "classes," and meets certain additional requirements which were here concededly met. The principal issue here is whether the income falls within that class described in §456(a)(2)(B): "Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months; . . . ."[3] Taxpayer asserts that the word "discovery" is

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3. The relevant portions of §456(a) are as follows:

"(a) Definitions. For the purposes of this section—

(1) Abnormal income. The term 'abnormal income' means income of any class described in paragraph (2) . . . if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 115 per centum of the average amount of the gross income of the same class for the four previous taxable years. . . .

(2) Separate classes of income. Each of the following subparagraphs shall be held to describe a separate class of income:

(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

broad enough to encompass its process. The government contends that in the context of the Act it relates only to discovery of coal, oil, gas and other natural resources. It bases this in part upon internal evidence, and in part upon legislative history.

Starting with subparagraph (B), standing alone, we note that the word "discovery" admits of so many meanings that some interpretation is called for.[4] The possibility of a number of meanings for one word is a species of ambiguity. We then observe that the word is not isolated, but is sandwiched between the words "exploration" and "prospecting." The government, accordingly, invokes the doctrine of *noscitur à sociis*. In case of ambiguity this is an "appropriate and reasonable," though not always determinative test. *Russell Motor Car Co.* v. *United States*, 1923, 261 U. S. 514, 519. On a proper occasion "such association justifies, if it does not imperatively require," the application of a restricted meaning. *Neal* v. *Clark*, 1877, 95 U. S. 704, 709. It is particularly appropriate where one meaning of each of the grouped words has a readily apparent com-

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(B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months; or

(C) Income from the sale of patents, formulae, or process, or any combination of the foregoing, developed over a period of more than 12 months; or

(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's method of accounting.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary."

4. According to Webster's New International Dictionary (Second Edition, Unabridged) it includes, "1. . . . Finding out or ascertaining something previously unknown or unrecognized; . . ." One of these meanings, which we will come to later, is "5. *Mining*. The original finding of part of a vein or lode. It is a prime requisite in the valid location of a mining claim."

mon denominator. Thus the words "barrel," "lock" and "stock" have each, individually, a number of quite different meanings. But if used in the phrase, "lock, stock and barrel" there could be little difficulty in determining which particular one of the several meanings was intended. The word "discovery" is clearly identified with the mining industry. See note 4, *supra*. So also are "exploration" and "prospecting." Accordingly we find a consistent, integrated unit, each portion of which casts light upon the other.[5]

Taxpayer makes no response to this (other than that set forth in the footnote), except a bare statement that the doctrine of *noscitur a sociis* is inapplicable. Its position is that since the dictionary permits it, "discovery" must be taken to comprehend inventions, or at least major "basic" inventions. If "discovery" is to have that breadth of meaning we could not accept any distinction based upon degrees of invention.[6] While we agree that basic inven-

5. Taxpayer counters by suggesting that by restricting all three words to mining there would be redundancy. That is not so. *"Discovery"* in this connection has already been defined. See note 4, *supra*. In the Encyclopedia Britannica (11th ed. 1911), in an article on Mining, is found the following: "MINING . . . . The term is not limited to [coal and ore deposits] . . . but includes . . . operations for oil, natural gas or brine . . . . *Prospecting* . . . . The work of prospecting is usually left to adventurous men . . . . The prospector is guided in his search by a knowledge of the geological conditions [etc.] . . . . *Exploratory Work* . . . . Exploratory work is associated intimately both with prospecting and with development, but the purpose is quite distinct from either prospecting, development or working, and it is of importance that this should be clearly recognized . . . ." (We quote the 11th edition of the Encyclopedia both because of its authoritative character, and because it was current when the words "exploration, discovery and prospecting" first appeared in the taxing statutes. See infra.)

6. It seems peculiarly inappropriate that a person in taxpayer's position should be the one to attempt a distinction between original invention and subsequent minor improvements. Taxpayer possessed over a hundred patents related to the development of its process. How is one to distinguish between that part of income attributable

tions can be described as discoveries, so may any invention, no matter how minor, if it is of sufficient consequence to be entitled to a patent. Cf. United States Constitution, Art. I, §8, Cl. 8; 35 U.S.C. §§100(a), 101. If the word "discovery" is to be taken as broad enough to include inventions, we see no reason for including some and excluding others. We are normally reluctant to adopt a construction of a taxing statute which would create difficult administrative problems.[7] We are entirely unwilling to do so here where the act makes no suggestion of any standard.[8]

However, there is an equally serious difficulty if "discovery" is to include all processes and patented inventions. What, then, is the purpose of subparagraph (C), "Income from the sale of patents, formulae, or processes," of

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to the original, basic invention, and that attributable to subsequent minor ones? This matter is, in a sense, moot in this case, because the parties have stipulated the amount of the tax. However, the problems it suggests are important.

7. As will be discussed later, certain changes were made in the KW Act over its World War II (WW II) counterpart for the express purpose of avoiding such problems.

8. In *G. D. Searle & Co.* v. *Jarecki*, 7 Cir., 1960, 274 F. 2d 129, a case seemingly on all fours with this one, except that it came up on the granting of the government's motion for summary judgment of dismissal, the taxpayer claimed as abnormal income under the KW Act income from sales of certain ethical drugs. It was agreed that prior to the time taxpayer had developed and patented the formulae such compounds had never been in existence, and that they had had enormous commercial success. The court said, "The common accepted meaning of the word 'discovery' includes 'Finding out or ascertaining something previously unknown or unrecognized; as Curie's *discovery* of radium' (Webster's New International Dictionary (Unabridged 2d ed.) p. 745)." Then, cautioning that it was not "indicating any expression of opinion on the factual issue," it remanded the case to the district court to determine whether these drugs were "actually discoveries" within that definition. In view of the facts already established with relation to these drugs, we are less than clear by what tests the district court is to resolve this question, or how, in general, the Commissioner is to distinguish those patentable inventions which are discoveries from those which are not.

456(a)(2)? See, *supra*, note 3. True, that subparagraph relates only to income from the *sale* of the patent or process. But subparagraph (B) relates to *all* income. If "discovery" in subparagraph (B) includes inventions, what is the rôle of subparagraph (C)? If there is a big hole in the fence for the big cat, need there be a small hole for the small one?

The existence of subparagraph (C) casts further light upon the intended meaning and scope of subparagraph (B). Suppose that instead of manufacturing under its patents, taxpayer had licensed its process to others. Would it be contended that the royalties could be claimed as abnormal income under subparagraph (B), although admittedly, should there be a sale of the process, the proceeds would fall under subparagraph (C)? Rather, it seems more reasonable to hold that Congress, having specifically provided for sales, did not intend by some more general clause to cover income of a similar nature but of less magnitude, i.e., income from a single year's use. There is an even more compelling argument. It is to be noted that §456 does not group together all sources of abnormal income, but is constructed so that the income-percentage requirements must be separately applied as to each classification or group. In determining whether, for example, abnormal income resulting from a judgment (A) is of sufficient size to qualify for relief, it is not possible to take into account abnormal income from prospecting (B). There could be no purpose to this unless each classification or group was intended to have some homogeneity within itself. This is an additional reason for applying the doctrine of *noscitur a sociis* within each group, and at the same time for differentiating one group from another. Taking the statute as a whole, we cannot accept the contention that subparagraph (B) was intended to encompass taxpayer's manufacturing income resulting

from its process. On the contrary, we think it clear that "discovery" as used in that subparagraph relates to the mining industries, and to nothing else.

Ordinarily we would stop here, but since the opposite conclusion was reached in *G. D. Searle & Co.* v. *Jarecki*, 7 Cir., 1960, 274 F2d 129, *supra* n. 8, we will deal briefly with the legislative history to which the government has devoted its brief. This history falls into two parts; the use since 1918 of the words "exploration," "discovery," and "prospecting" in conjunction, solely with relation to the mining industry, and the particular changes effected by the KW Act over its predecessor, the World War II Act.[9] In Title III, "War-Profits and Excess-Profits Tax," of the Revenue Act of 1918, c. 18, 40 Stat. 1057 (1919), we find a limit placed on the excess profits tax that could be imposed on the proceeds from "a bona fide sale of mines, oil or gas wells, . . . where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer. . . ." Section 337, 40 Stat. 1096. An identical provision in the income tax portion of the statute, §211(b), 40 Stat. 1064, limited the surtax upon such income in the case of individual taxpayers. Congressional history discloses that these provisions were designed to encourage the search for oil and ore deposits during wartime, and to offset the unfairness of taxing in a single year income which was possibly the result of many unprofitable years of prior search. See S. Rep. No. 617, 65th Cong., 3d Sess. 6 (1918) (1939—1 Cum. Bull. (Part 2) 117, 120-21). They were repeated in the income tax and the excess profits tax titles of the Revenue Act of 1921, c. 136, §§211(b), 337, 42 Stat.

9. Excess Profits Tax Act of 1940, c. 757, 54 Stat. 975, which, together with later additions and amendments, was classified as §§710-84, Int. Rev. Code of 1939, and is hereinafter referred to as the WW II Act.

237, 277. There was no further excess profits taxation until 1940, but these words continued to appear in the income tax statutes, with one exception,[10] until excess profits tax imposition returned with World War II. By that time, in the light of this repeated and almost continuous application to the mining industry (and no other), we think that these words had become well-recognized words of art.

The World War II excess profits tax act exhibits a major schematic change from the earlier acts, but again we find the words "exploration," "prospecting," and "discovery" used together in a relief provision. The here relevant portion (noticeably similar, as will be seen, to §456 of the KW Act) was §721(a)(2)(C)):[11] "Income resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months; . . . ." Discussion on the floor of Congress indicates that the mining industry was intended as one of the primary beneficiaries of this relief. See, e.g., 86 Cong. Rec. 12174-77, 12350, 12919 (1940); 87 Cong. Rec. 1636 (1941). With the Korean War enactment, subparagraph (C) of §721(a)(2) was split in two. It is interesting to note the form of this division. The words "exploration, discovery, prospecting" were taken as one group, and placed in subparagraph (B) of the new

10. The single exception is the Revenue Act of 1934, c. 277, 48 Stat. 680. When the provision was revived in the Revenue Act of 1936, c. 690, §105, 49 Stat. 1678, the phrase in question was changed to "prospecting or exploration or [instead of "and] discovery work," and the section as a whole was limited to oil or gas property. In this form it was carried into the Internal Revenue Code of 1939, c. 2, §105, 53 Stat. 36 (now §632 of the Int. Rev. Code of 1954).

11. Excess Profits Tax Act of 1940, c. 757, §201, 54 Stat. 986, as amended, Excess Profits Tax Amendments of 1941, c. 10, §5, 55 Stat. 21. Subparagraph (C) of the amended act was derived from, and is practically identical to, subsection (c) of the original §721.

law, while "patents, formulae, or processes" were placed together in subparagraph (C), and at the same time the words "research, or development of tangible property" were dropped. These changes "redefined and restricted" the types of income to which this special treatment was to be afforded. H.R. Rep. No. 3142, 81st Cong., 2d Sess. 63 (1950) (1951—1 Cum. Bull. 187, 231). The House and Senate reports described the excised portion as a "potential loophole of major dimensions," and stated that it was being omitted "because there appeared to be no means of restricting such an adjustment to truly meritorious cases other than by the introduction of a large degree of administrative discretion of the type required by the general relief clause of the World War II law (section 722), and because the need for a reallocation of such income seemed to be materially less than in the other classes of income described . . . ." *Id.* at 13 (1951—1 Cum. Bull. at 195); S. Rep. No. 2679, 81st Cong., 2d Sess. 14 (1950) (1951)—1 Cum. Bull. 240, 249). Thus even "meritorious cases" that would have come under this now excluded phrase were deliberately sacrificed in the interest of administrative simplification.[12]

In the face of this history, it would be difficult for us to feel that there was introduced into the newly created subparagraph (B) with the word "discovery" a scope of meaning which would include manufacturer's profits from inventions, whether those inventions were revolutionary, or otherwise. Taken in conjunction with internal evidence within the statute itself, we find it impossible.

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12. In this connection it is to be noted that it was stipulated that taxpayer's income from its process was "income from the sales of tangible property arising out of research and development which extended over a period of more than 12 months." Thus taxpayer must contend that it remained within the purview of this statute after the words which were the most applicable to it were removed.

We turn next to taxpayer's contention that even if it is not entitled to classify the income in question as "discovery" income under §456(a)(2)(B), it is nonetheless entitled to relief under the last sentence of subsection (a)(2). This reads, "The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary." Note 3, *supra*. The relevant regulations are set forth below.[13] We agree with taxpayer that this sentence may be taken as giving the Secretary the authority to accept classifications outside of the express provisions of subparagraphs (A)-(D). But the language is permissive, and we have found nothing in the historical background indicating that the Secretary's role in agreeing to additional classifications was to be one of obligation rather than of discretion. We therefore reject any contention that the Secretary, or Commissioner, was required to grant relief on the basis of a classification suggested by a taxpayer merely because the taxpayer has income which meets the other tests of abnormality. Nor do the regulations themselves assist the taxpayer. First, any classification by a taxpayer is "subject to approval by the Com-

13. Treas. Regs. 130, §40.456-2(b) (1951), as amended, T.D. 6026, 1953—2 Cum. Bull. 235: "Other income, not within a class described in subparagraphs (A)-(D) of section 456(a)(2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456(a)(2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice. Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise properly includible within a class of income to which such section is applicable, for example, the class described in section 456(a)(2)(D)."

missioner," and such approval was not given here. Secondly, under this regulation the classification must be "similar to those specified in subparagraphs (A)-(D) . . . ." If "discovery" relates to mining and natural resources, taxpayer's classification is not "similar." It may be similar (if in fact it is not completely described by the phrase) to "research or development," but the regulations, in accord with the legislative history already discussed, specifically state that income of this class is not subject to relief. The last sentence of the regulations, on which taxpayer places great emphasis, furnishes it no support. That sentence merely provides that income otherwise properly includible within a class is not to be excluded merely because it happens to constitute income from research and development. However, we are unable to find, either in the statute or in the regulations, any class in which to place taxpayer's income other than a classification which is specifically excluded.

One matter remains. Taxpayer, prior to the instant case, pursued a claim for relief under §722 of the WW II Act for overassessments of excess profits taxes for the years 1942 and 1943. In 1951 it was successful. In connection with the settlement it was credited with interest. The government agrees that this interest was abnormal income in 1951. Section 456(a)(2)(A). However, under the WW II Act, the reduction of taxpayer's excess profits income correspondingly increased its normal-tax income, resulting in a deficiency for those years, and an interest charge thereon. The Commissioner held, and was sustained by the Tax Court, that in computing 1951 net abnormal income this interest charge should be subtracted from the abnormal income (i.e., the interest credit) as one of the "costs or deductions relating to such abnormal in-

come, allowable in determining the normal-tax net income for the taxable year . . . ."[14]

It is true that the interest charge was a result of, and therefore attributable to, the overassessment to which the interest credit was also attributable. Therefore, in a broad sense, they were "related." It is also true that this charge would, in the general compass of the word, constitute a "deduction" "allowable in determining the normal-tax net income." Int. Rev. Code of 1939, §23(b). There is one little cloud. What is the word "costs" doing there? Having in mind the broad meaning that might be given to "deductions" standing alone (as, indeed, including costs), does the presence of the word "costs" suggest that "deductions relating" was intended to mean something relating in the same manner as costs? In H.R. Rep. No. 3142, 81st Cong., 2d Sess. 63 (1951—1 Cum. Bull. 187, 231), it is stated that the clause here in question was intended principally as a "clarification of the technical provisions" of §721(a)(3) of the WW II Act. Examination of this earlier statute[15] discloses that whatever clarity it may have lacked in other respects, it was entirely clear with regard to the present question. There the phrase corresponding to "deductions relating" ("to such abnormal income") was "expenses, . . . through the expenditure of which" ("such

14. "(3) Net abnormal income. The term 'net abnormal income' means the amount of the abnormal income less, under regulations prescribed by the Secretary, (A) 115 per centum of the average amount of the gross income of the same class determined under paragraph (1), and (B) an amount which bears the same ratio to the amount of any costs or deductions relating to such abnormal income, allowable in determining the normal-tax net income for the taxable year, as the excess of the amount of such abnormal income over 115 per centum of such average amount bears to the amount of such abnormal income." Section 456(a)(3).

15. The corresponding portion of §721(a)(3) reads as follows: ". . . direct costs or expenses, deductible in determining the normal-tax net income of the taxable year, through the expenditure of which such abnormal income was in whole or in part derived . . ."

abnormal income was in whole or in part derived"). This was a limited, causative relationship, entirely compatible with the word "costs," and falling far short of the meaning contended for here by the government. It is true that we are to apply §456(a)(3) and not §721(a)(3). On the other hand, by reading §456(a)(3) in the manner contended by the government we find an awkwardness in, and apparent absence of purpose for, the presence of the word "costs," while we find none if this statute is construed to read like its predecessor. In view of the legislative history, we will adopt that construction.[16]

It may be that from an "equitable" standpoint it would be appropriate for taxpayer's interest out to be offset against its interest in. But as the government was quick to assert when the shoe was on the other foot, we are applying tax statutes, not principles of equity. See *Babcock & Wilcox Co.* v. *Pedrick*, 2 Cir., 1954, 212 F. 2d 645, *cert. den.*, 1955, 348 U. S. 936. This ruling of the Tax Court must be set aside.

Judgment will enter vacating the decision of the Tax Court, and remanding the case for further proceedings in accordance with this opinion.

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16. For what it may be worth, we note that the example given by the Regulations (Treas. Regs. 130, §40.456-1(e) (1951), with respect to this clause hypothesizes "deductible expenses," not just "deductions."

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 5622.

POLAROID CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JUDGMENT

May 3, 1960.

This cause came on to be heard on the record on review from The Tax Court of the United States and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The decision of the Tax Court is vacated, and the case is remanded to that Court for further proceedings in accordance with the opinion passed down this day.

By the Court:

ROGER A. STINCHFIELD
Clerk

APPENDIX C

UNITED STATES CONSTITUTION

Article 1 Section 1:

All legislative powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

Article 1 Section 8, Clause 18:

The Congress shall have Power * * *

To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

STATUTE

Section 456 of the 1939 Internal Revenue Code

§456. *Abnormalities in income in taxable period*

(a) *Definitions.* For the purposes of this section—

(1) *Abnormal income.* The term 'abnormal income' means income of any class described in paragraph (2) includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 115 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

(2) *Separate classes of income.* Each of the following subparagraphs shall be held to describe a separate class of income:

(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

(B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months; or

(C) Income from the sale of patents, formulae, or processes, or any combination of the foregoing, developed over a period of more than 12 months; or

(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's method of accounting.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary.

(3) *Net abnormal income.* The term 'net abnormal income' means the amount of the abnormal income less, under regulations prescribed by the Secretary, (A) 115 per centum of the average amount of the gross income of the same class determined under paragraph (1), and (B) an amount which bears the same ratio to the amount of any costs or deductions relating to such abnormal income, allowable in determining the normal-tax net income for the taxable year, as the excess of the amount of such abnormal income over 115 per centum of such average amount bears to the amount of such abnormal income.

(b) *Amount attributable to other years.* The amount of the net abnormal income that is attributable to any previous or future taxable year or years, shall be determined under regulations prescribed by the Secretary. In the case of amounts otherwise attributable to future taxable years, if the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation, then there shall be attributable to the first taxable year in which such transfer or distribution occurs (or if such year is previous to the taxable year in which the abnormal income is includible in gross income, to such latter taxable year) all amounts so attributable to future taxable years not included in the gross income for a previous taxable year.

(c) *Computation of tax for current taxable year.* The tax under this subchapter for the taxable year, in which the whole of such abnormal income would without re-

gard to this section be includible, shall not exceed the sum of:

(1) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of the net abnormal income which is attributable to any other taxable year, and

(2) The aggregate of the increase in the tax under this subchapter for the taxable year (computed under paragraph (1)) and for each previous taxable year which would have resulted if, for each previous taxable year to which any portion of such net abnormal income is attributable, an amount equal to such portion had been included in the gross income for such previous taxable year.

(d) *Computation of tax for future taxable year.* The amount of the net abnormal income attributable to any future taxable year shall, for the purposes of this subchapter, be included in the gross income for such taxable year.

(1) The tax under this subchapter for such future taxable year shall not exceed the sum of—

(A) the tax under this subchapter for such future taxable year computed without the inclusion in gross income of the portion of such net abnormal income which is attributable to such year; and

(B) the decrease in the tax under this subchapter for the previous taxable year in which the whole of such abnormal income would, without regard to this section, be includible which resulted by reason of the computation of such tax for such previous taxable year under the provisions of subsection (c); but the amount of such decrease shall be diminished by the aggregate of the increases in the tax under this subchapter for the future taxable year as computed under subparagraph (A) and for the taxable years intervening between such previous taxable year and such future taxable year

which have resulted because of the inclusion of the portions of such net abnormal income attributable to such intervening years in the gross income for such intervening years.

(2) If, in the application of subsection (c), net abnormal income from more than one taxable year is attributable to any future taxable year, paragraph (1) of this subsection shall be applied with respect to such future taxable year in the order of the taxable years from which the net abnormal income is attributable beginning with the earliest, as if the portion of the net abnormal income from each such year was the only amount so attributable to such future taxable year, and (except in the case of the portion for the earliest previous taxable year) as if the tax under this subchapter for the future taxable year was the tax determined under paragraph (1) with respect to the portion for the next earlier previous taxable year.

(3) If in the application of paragraph (1) to any future taxable year it is determined that the decrease in tax computed under paragraph (1) (B) with respect to the net abnormal income, a portion of which is included in the gross income for the future taxable year, does not exceed the aggregate of the increases in tax computed under paragraph (1) (B) with respect to such net abnormal income, then the portions of such net abnormal income attributable to taxable years subsequent to such future taxable year shall not be included in the gross income for such subsequent taxable year. For the purpose of computing the tax under this subchapter for a taxable year subsequent to the future taxable year, the portion of net abnormal income attributable to the future taxable year shall not be included in the gross income for such future taxable year to the extent that the inclusion of such portion of net abnormal income in the gross income for such future taxable year did not result in an increase in tax for such future taxable year by reason of the provisions of paragraph (1).

(e) *Application of section.* This section shall be applied only for the purpose of computing the tax under this subchapter as provided in subsections (c) and (d), and shall have no effect upon the computation of base period net income. For the purposes of subsections (c) and (d)—

(1) Net abnormal income means the aggregate of the net abnormal income of all classes for one taxable year.

(2) Under regulations prescribed by the Secretary, the tax under this subchapter for previous taxable years shall be computed as if the portions of net abnormal income for each previous taxable year for which the tax was computed under this section were included in the gross income for the other previous taxable years to which such portions were attributable.

(3) If both subsections (c) and (d) are applicable to any current taxable year, subsection (d) shall be applied without regard to subsection (c), and subsection (c) shall be applied as if the tax under this subchapter, except for subsection (c), was the tax computed under subsection (d) and as if the gross income and the other amounts necessary to determine the adjusted excess profits net income were those amounts which would result in the tax computed under subsection (d)."

Regulations

"Reg. 130, Sec. 40.456-1. *Abnormalities in income in taxable year.*—(a) Section 456 applies if abnormal income (as defined in section 456(a)) for any excess profits tax taxable year is attributable to other taxable years. The term 'abnormal income' means income of any class described in section 40.456-2 includible in the gross income of the taxpayer for any excess profits tax taxable year

(1) if it is abnormal for the taxpayer to derive gross income of such class, or (2) if the taxpayer normally derives gross income of such class but the amount of such income of such class is in excess of 115 percent of the average amount of the gross income of the same class determined for the four previous taxable years or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence. It is abnormal for a taxpayer to derive income of any class only if the taxpayer had no gross income of that class for the four previous taxable years. For the purpose of determining abnormal income under this paragraph the gross income of the class for the previous taxable years is not to be increased or decreased by any allocation under the provisions of section 456. Abnormal income is to be determined by considering classes of income, and not merely particular items. * * *"

"Reg. 130, Sec. 40.456-2. *Classification of income.* (a) Section 456(a) (2) (A), (B), (C), and (D) sets forth four separate classes of income. All the income which reasonably is classifiable in more than one class shall be classified under the one which the taxpayer irrevocably elects. Such election shall be made in the manner prescribed in section 40.456-3. The classification of income for any year must be consistent with the classification made under section 456 for previous years. The classification must also be consistent with any classification made in applying section 433(b) (9) to the taxpayer.

(b) Other income, not within a class described in subparagraphs (A)-(D) of section 456(a) (2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commission on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456(a)

(2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice. Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise properly includible within a class of income to which such section is applicable, for example, the class described in section 456 (a) (2) (D)."

APPENDIX D

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1959—JANUARY SESSION, 1960

G. D. SEARLE & Co.,
Plaintiff-Appellant,

v.

JOHN T. JARECKI, former Collector of Internal Revenue, and Ernest J. Sauber, former Collector of Internal Revenue and former District Director of Internal Revenue,
Defendants-Appellees.

No. 12747.

January 27, 1960

CASTLE, Circuit Judge.

G. D. Searle & Co., plaintiff-appellant, referred to as taxpayer, instituted this action to recover excess profits taxes in the total amount of $3,638,238.82, plus interest, which amount it alleges was erroneously and illegally assessed and collected by the Government for the calendar years 1950, 1951, and 1952. The District Court dismissed the suit on motion for summary judgment filed by the Government. The taxpayer appealed contending

the granting of summary judgment was error in that it was based on an erroneous interpretation of the pertinent Internal Revenue Code provision and that a genuine issue of material fact existed.

The pleadings, a stipulation of facts, and answers to interrogatories and requests for admissions disclose that the taxpayer is engaged in the manufacture and marketing of ethical drugs. Prior to 1950, and over a period of more than twelve months, the taxpayer incurred expenditures which resulted in the preparation and manufacture of two pharmaceuticals with the trade names of Banthine and Dramamine. During the years here involved the taxpayer derived income from sales of these drugs. Both were developed from and arose out of research activities conducted by the taxpayer before 1950. These chemical drug compounds were not in existence prior to their being prepared through experiments with various chemical formulas. The taxpayer applied for and received patents on both products.

The taxpayer claimed that the income from the sales of Banthine and Dramamine constituted abnormal income within the meaning of Sec. 456(a) (2) of the Internal Revenue Code of 1939 (26 U. S. C. Excess Profits Taxes, 456).[1] Section 456 is designed to afford relief from the

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1. Insofar as pertinent Sec. 456 provides:

"§ 456. Abnormalities in income in taxable period—

"(a) Definitions.

"For the purposes of this section—

"(1) Abnormal income.

"The term 'abnormal income' means income of any class described in paragraph (2) includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 115 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in

impact of excess profits taxes in certain situations which give rise to abnormally high income during the taxable year.

The taxpayer asserted that the income from the drugs Banthine and Dramamine qualified as income resulting from "discovery" within the class of income described in Sec. 456(a) (2) (B) as:

> "Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months;"

And, alternatively, the taxpayer asserted that such income is subject to classification as abnormal income pursuant to the Treasury Regulations[2] promulgated under the provision of Sec. 456 that:

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existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

"(2) Separate classes of income.

"Each of the following subparagraphs shall be held to describe a separate class of income:

"(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

"(B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months; or

"(C) Income from the sale of patents, formulae, or processes, or any combination of the foregoing, developed over a period of more than 12 months; or

"(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's method of accounting. All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary."

2. Treasury Regulations 130, Sec. 40.456-2(b), as amended by T.D. 6026 (1953-2) Cum. Bull. 235:

> "(b) Other income, not within a class described in subparagraphs (A)-(D) of section 456(a)(2), to which section 456 is applicable, may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in

"The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary".

The District Court held that the meaning of the word "discovery" as used in the statute, did not encompass the preparation of Banthine and Dramamine because they are products arising out of research and development, and that the Treasury Regulation, to which reference has been made, is not applicable.

The common accepted meaning of the word "discovery" includes "Finding out or ascertaining something previously unknown or unrecognized; as Curie's *discovery* of radium" (Webster's New International Dictionary (Unabridged 2d ed.) p. 745). We do not deem the maximum *noscitur a sociis* applicable. The wording of subparagraph (B) of the statute indicates that each word should be given significance independently of the others. It refers to "exploration, discovery, or prospecting, or any combination of the foregoing". The context in which the word appears suggests no reason to limit or qualify its commonly accepted meaning. That the statute herein involved omitted a provision of a similar World War II Excess Profits Tax Act which in defining abnormal income included that resulting from "research, or development of tangible property", does not in our opinion serve

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subparagraphs (A)-(D) of section 456(a)(2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in light of the taxpayer's business experience and accounting practice. Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise properly includible within a class of income to which such section is applicable, for example, the class described in section 456(a)(2)(D)."

to narrow the scope of the word "discovery" as employed in the Internal Revenue Code provision here under consideration. The elimination of "research" and "development" as factors qualifying income for abnormal income classification served the Congressional objective of plugging "a potential loophole of major dimensions".[3] And, absent the element of discovery, income resulting from research or development does not by reason of the latter factors qualify for treatment as abnormal income. But the plugging of the loophole which existed under a former Act because of the use of the unqualified terms "research" and "development" does not require that the word "discovery" which the Congress saw fit to re-employ in the later enactment be regarded as having taken on the limited and qualified meaning the Government would ascribe to it. Neither the context of Sec. 456 nor the legislative history demonstrates that the term "discovery" was intended to describe only the discovery of that which is already in existence *i. e.* natural resources. If Congress had intended to limit the meaning of "discovery" it would have been a simple matter for it to have expressly done so.

It is our opinion that income resulting from discovery is not under the terms of subparagraph (B) of the statute precluded from classification as abnormal income merely because research or development may have occasioned, or have been factors which contributed to, the discovery. It is unnecessary to consider the argument advanced by the taxpayer concerning the application of the Treasury Regulation.

We conclude that the District Court erred in its interpretation of the statute and in granting summary judgment for the Government. A genuine issue of material fact existed as to whether Banthine and Dramamine were

3. H. Rep. No. 3142, 81st Cong., 2 Sess., p. 13 (1951-1 Cum. Bull. 187, 189).

actually discoveries. Nothing we have said should be regarded as indicating any expression of opinion on the factual issue.

The Judgment of the District Court is reversed and the cause remanded for further proceedings not inconsistent with this opinion.

Reversed and remanded.